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PW Case # 2005-034

(Woodhaven Manor Apartments City of Rancho Cucamonga)

In August 2006, the San Francisco Superior Court set aside PW 2005-034 (Woodhaven Manor Apartments) and decided that state low income housing tax credits ("LIHTCs") fall within the definition of "paid for in whole or in part out of public funds" under Labor Code section 1720(b)(3). The Department is awaiting the judgment and order of the court, which it will appeal. Under California Code of Civil Procedure section 916, an appeal stays proceedings in the trial court, including enforcement. The final status of PW 2005-034 will be determined on appeal.

STATE OF CALIFORNIA

DEPARTMENT OF INDUSTRIAL RELATIONS

DECISION ON ADMINISTRATIVE APPEAL
IN RE: PUBLIC WORKS CASE NO. 2005-034
WOODHAVEN MANOR APARTMENTS

Introduction

The State Building and Construction Trades Council of California, AFL-CIO ("SBCTC") timely filed an administrative appeal of the coverage determination ("Determination") dated November 16, 2005. Southern California Housing Corporation and the California Coalition of Affordable Housing submitted responses to the appeal. All of the submissions have been considered carefully. Except as noted below, they raise no new issues not already addressed in the Determination. Therefore, for the reasons set forth in the Determination, and for the additional reasons stated herein, the appeal is denied, and the Determination dated November 16, 2005, is affirmed and incorporated herein by reference.

Discussion

I. The Allocation of Low Income Housing Tax Credits is Not The Payment of Money or the Equivalent of Money by the State.

SBCTC contends that the allocation of low income housing tax credits ("LIHTCs")¹ by the California Debt Limit Allocation Committee ("CDLAC") constitutes payment for construction out of public funds within the meaning of

Labor Code section 1720.² SBCTC first disputes the Department's finding that the allocation of tax credits is not a "payment of money or the equivalent of money" within the meaning of section 1720(b)(1). SBCTC asserts that the Department's analysis ignores the "reality" that the tax credits are transferable and have "monetary value to investors." (Appeal at 2.) This claim is discussed in the context of section 1720(b)(3) below. In the present context it is sufficient to note that irrespective of SBCTC's claim, the reality remains that the credits do not constitute "payment of money or the equivalent of money" within the meaning section 1720(b)(1) (emphasis supplied.) An LIHTC "involves no expenditure of public moneys received or held ... but merely reduces the taxpayer's liability for total tax due." *Center for Public Interest Law v. Fair Political Practices Comm'n* (1989) 210 Cal.App.3d 1476, 1486.³ As the United States Supreme Court recognized in *Randall v. Loftsgaarden* (1986) 478 U.S. 647, 656-657:

The ... tax deductions or tax credits ... have no value in themselves; the economic benefit to the investor - the true "tax benefit" - arises because the investor may offset tax deductions against income received from other sources or use

¹ SBCTC does not distinguish between federal and state LIHTCs. Accordingly, unless otherwise indicated, the term LIHTC is used herein to refer to both federal and state credits.

² All subsequent statutory citations are to the California Labor Code unless otherwise indicated.

³ SBCTC suggests that the Department has quoted *Center for Public Interest Law* out of context by omitting the phrase "within the meaning of Penal Code section 426." SBCTC asserts that the definition in that section is "far narrower than the definition in Labor Code section 1720." (Appeal at 1, n.1.) In fact, the court emphasized the "inclusive language of Penal Code section 426's definition of 'public monies.'" *Center for Public Interest Law*, *supra*, 210 Cal.App.3d at 1481. SBCTC additionally argues that the court was referring to "an entirely different type of tax credit." (Appeal at 1, n.1.) This is a distinction without a difference. Neither type of credit entails an expenditure of public funds, and neither can be regarded as a "payment."

tax credits to reduce the taxes otherwise payable on account of such income. Unlike payments in cash or property received by virtue of ownership of a security - such as distributions or dividends on stock, interest on bonds, or a limited partner's distributive share of the partnership's capital gains or profits - the "receipt" of tax deductions or credits is not itself a taxable event, for the investor has received no money or other "income" within the meaning of the Internal Revenue Code.

Similarly, the allocation of LIHTCs does not entail receipt of money or the equivalent of money. LIHTCs are spread over a period of years, unlike the value of cash or other assets, which carry their full value at all times. Unlike cash or other assets, LIHTCs are lost if the housing development is not completed on a timely basis, if the property is not used for low income housing, or if the taxpayer fails to timely file an income tax return. Unlike cash or other assets, LIHTCs can be used only if the taxpayer has income.

II. The Allocation of Low Income Housing Tax Credits is Not a Transfer by the State of an Asset of Value for Less Than Fair Market Price.

SBCTC also disputes the Department's finding that the allocation of LIHTCs is not a "[t]ransfer by the state or a political subdivision of an asset of value for less than fair market price" within the meaning of section 1720(b)(3). SBCTC asserts that: "The tax credits are also an 'asset of value' provided by the State for less than 'fair market price.'" Appeal at 2. It is significant that the statutory term is "transfer," not "provide." The allocation of LIHTCs cannot be regarded as a transfer, because a transfer necessarily entails ownership, and CDLAC does not own the tax credits.

SBCTC's assertion that tax credits are an "asset of value" flies in the face of the Supreme Court's direct statement in *Randall*, *supra*, that tax credits "have no value in themselves." That statement applies to LIHTCs. *United States v. Griffin* (5th Cir. 2003) 324 F.3d 330, 354-355 held with regard to LIHTCs:

Unissued tax credits have zero intrinsic value. Therefore, tax credits are not property when they are in the [Texas Department of Housing and Community Affairs'] possession. ... Once tax credits have been allocated, they cannot be transferred from the property to which they were allocated. If they tax credits cannot be used because the property to which they were allocated does not become a low-income residence, the federal government reclaims the tax credits. The tax credits are not actually issued on a project involving new construction ... until the rental units actually have been constructed at reduced rent for low-income occupants. Once the tax credits have been issued on a property, the owner can sell limited partnership interests in the property so that investors can take advantage of the tax credits allocated to that project.

Case law holds unambiguously that LIHTCs "do not constitute a right to a payment of money, have no independent value, and are not freely transferable upon receipt." *Rainbow Apartments v. The Illinois Property Tax Appeal Board*, 762 N.E.2d 534, 537 (Ill.App.Ct. 2002). Yet SBCTC insists, without authority, that LIHTCs are transferable and have an easily ascertainable "fair market price" that "can be measured by looking to the price actually paid by investors to purchase the credits ..." (Appeal at 2.)

SBCTC misapprehends the nature of the transaction through which an investor acquires the opportunity to use

LIHTCs. As the court explained in *Rainbow Apartments*,
supra, 326 Ill.App.3d at 1108:

A limited partnership does not "sell" the tax credits to investors; they remain in the limited partnership. Limited partners buy securities giving them an interest in the limited partnership. The benefit of a tax credit to a limited partner is entirely incidental to the investment.

Thus, contrary to SBCTC's assertions, LIHTCs are not traded, but remain with the equity owners of the project for the life of the credits. The only way the LIHTCs can change hands is for the equity ownership itself to change hands. The Oregon Supreme Court cogently explained the SBCTC program in *Bayridge Associates Limited Partnership v. Dept. of Revenue* (Or. 1995) 892 P.2d 1002, 1004, 321 Or. 21:

The low-income housing tax credit is available for certain low-income housing projects. IRC § 42(a), (c)(2), (g). In order to qualify for that credit, the owner of, or investor in, an apartment complex must make available a certain number of rental units in the project for use by the general public on a residential (i.e., non-transient and non-commercial) basis for not less than 15 years. IRC § 42(g), (i)(1). If the owner or investor qualifies, section 42 provides income tax credits to the owner or investor over a 10-year period, IRC § 42(f)(1), based on the cost of the building and the proportion of the building used by low-income tenants, IRC § 42(a)-(d).

...
If a project fails to comply with the tenant and rent limitations in IRC § 42 at any time during the 15-year compliance period, the taxpayer is subject to a recapture of a portion of the credit claimed. IRC § 42(j). Additional taxes, plus interest, will be due as a result. IRC § 42(j)(2). When a sale occurs before the end of the 15-year compliance period, it is possible to avoid recapture on the sale of a low-income

housing project that qualifies for tax credits under IRC § 42. To accomplish that, the seller of the project must post a bond in an amount satisfactory to, and for the period required by, the Secretary of the Treasury, if it reasonably is expected that the project will continue to be operated as a qualified low-income project for the remainder of the building's compliance period. IRC § 42(j)(6). The amount of the required bond generally equals or exceeds the value of the credits claimed or available.

Turning to the facts before it, the court held, at 892 P.2d 1006, that the conditions imposed upon the limited partnership were "governmental restrictions" that reduced the value of the property for purposes of the tax assessment:

Taxpayers entered into an agreement with OHA that limited the rents that taxpayers could charge to tenants residing in taxpayers' properties and limited the pool of tenants to whom they could rent apartments. Taxpayers agreed to those limitations for a period of 15 years. As of the assessment date, those limitations restrained how taxpayers could enjoy their property. Those limitations came from a binding agreement with a governmental agency, the breach of which would entail serious financial consequences to taxpayers. Thus, the limitations were "governmental restrictions."

Furthermore, under those governmental restrictions, taxpayers must provide a certain number of residential housing units. That is, taxpayers must maintain at least a part of the complexes as residential. Even if taxpayers wanted to use the properties for non-residential purposes (such as commercial purposes), and even if those uses were permitted by applicable zoning laws, the governmental restrictions placed on those properties would inhibit such a use. Those limits on what taxpayers may do with their properties, resulting from taxpayers' participation in the section 42 program,

constitute "governmental restriction[s] as to use." (Emphasis in original.)

Thus, even assuming *arguendo* that SBCTC was correct in its assertion that LIHTCs have value measurable "by looking to the price actually paid by investors to purchase the credits"⁴ (Appeal at 2), it does not follow that they are being transferred by the state for less than fair market price. SBCTC's argument implies that the LIHTCs are essentially a gift from the state, but that is hardly the case. The "price" for receiving the allocation of LIHTCs is a covenant running with the land that restricts rents and occupancy of the property for many years to come, which serves to diminish the value of the investment. To pretend such a price does not exist, or to assume without evidence that it is less than fair market is, in SBCTC's words, to ignore reality.

In sum, when LIHTCs are allocated, they are not "assets of value," and they are not being "transfer[red]" by the state, at "less than fair market price" or otherwise. Accordingly, the allocation of LIHTCs is not payment out of public funds as defined by section 1720(b)(3).

III. The Allocation of Low Income Housing Tax Credits is Not Otherwise Payment Out of Public Funds.

SBCTC also asserts, without explanation, that "receipt of tax credits at issue here meets the definitions of 'paid for in whole or in part out of public funds' set forth in Labor Code sections 1720(b)(4) and (6)." This assertion is rejected for the reasons stated in the initial

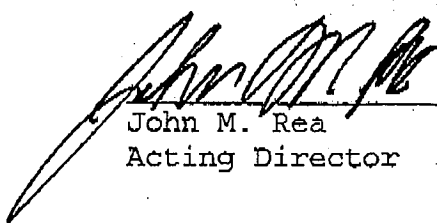
⁴ This assertion is in fact incorrect because, as discussed above, investors do not simply "purchase" LIHTCs, but rather, purchase an equity interest in the development.

determination. Finally, SBCTC argues that "statutory exclusions of explicitly enumerated projects - including projects receiving [LIHTCs] prior to December 2003 - makes [sic] clear the legislative intent to include ... those low income housing developments ... that receive [LIHTCs] after 2003." (Appeal at 3.) This argument is rejected for the reasons stated in PW Case No. 2004-016, Rancho Santa Fe Village Senior Affordable Housing Project (February 25, 2005).

Conclusion

In summary, for the reasons set forth in the Determination, as supplemented by this Decision on Administrative Appeal, SBCTC's appeal is denied and the determination that the Woodhaven Manor Apartments Project is not a public work is affirmed. This decision constitutes final administrative action in this matter.

DATED: 12 Jan 06



John M. Rea
Acting Director